RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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IMPORTANT! See page 5, "LATE NOTES"

April 22, 1977 **LETTER 695**

April 7, DJIA 918.88; PTI 803; A-D Ratio –20.82
April 15, DJIA 947.76; PTI 836; A-D Ratio –19.65

WHAT IF THEY MEAN IT!: A few days ago Budget Director Bert Lance disarmed career budget officials when he announced, "*As we say down in Georgia, you can write this on the wall, spit on it and walk away from it. We are going to balance the budget in 1981.*" As Washington and the nation's businessmen are coming increasingly to understand, when Thomas Bertram Lance speaks, Jimmy Carter means it. Well, if Jimmy Carter actually intends to balance the budget by 1981, you're going to see one hell of a bull market in bonds (and probably in stocks). Now that's worth pondering (assuming, of course, that Bert Lance and Jimmy Carter really mean it). I happen to think they do. And they have the primary trend to help them out, which, in case you didn't know it, is no small thing).

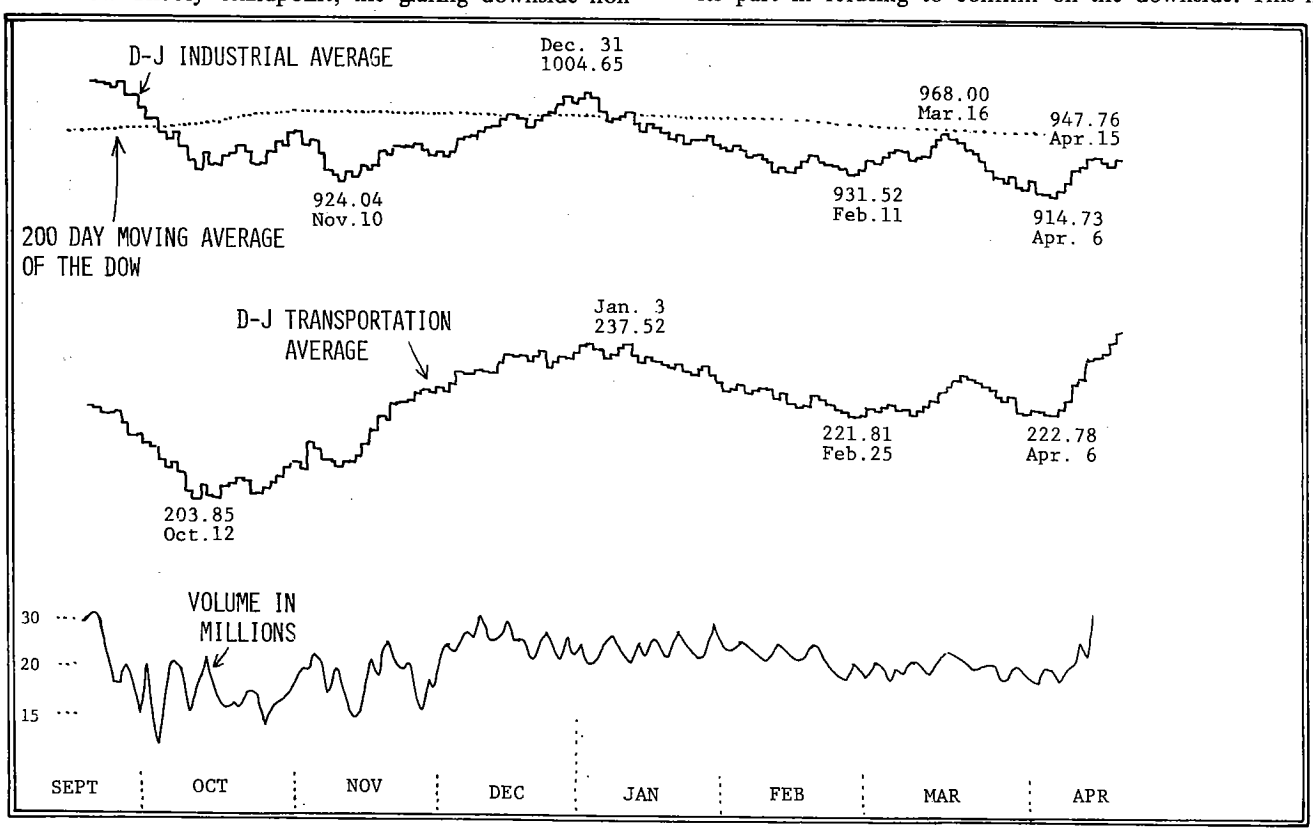
The Carter energy proposals are now out in the open. I think he means what he says here, just as I think Carter means what he says about balancing the budget. Carter's energy and budget plans will have a momentous effect on the nation. Can we blame the market for backing off, twisting and turning, erupting and contorting as it tries to measure all the ramifications of the events of 1977? A weak market, a primary bear market, would have crashed on 1977's news. I continue to think that this market is giving a constructive account of itself.

THE MARKET: The story of this market over the past six months has been one of **non-confirmations on the downside.** From the Dow Theory standpoint, the glaring downside non-confirmation, the one I've been writing about for month after month, has been the Transportation Average's refusal to confirm the weakness of Industrials. Let's have a brief review. Important secondary lows were established last year. Transports at 203.85 (Oct. 12), Industrials at 924.04 (Nov. 10). After a rally from those lows, the Averages failed to agree on the upside (see chart below), and the trouble began.

In February, Industrials sank to 931.52, Transports to 221.81. A feeble rally ensued, followed by a renewed decline. At that point I stated that regardless of the widely heralded weakness in the Industrial Average, the Transports "never looked stronger." I emphasized that persistent strength in one Average (in this instance, Transports) would most definitely *negate weakness in the other Average* (in this case, Industrials).

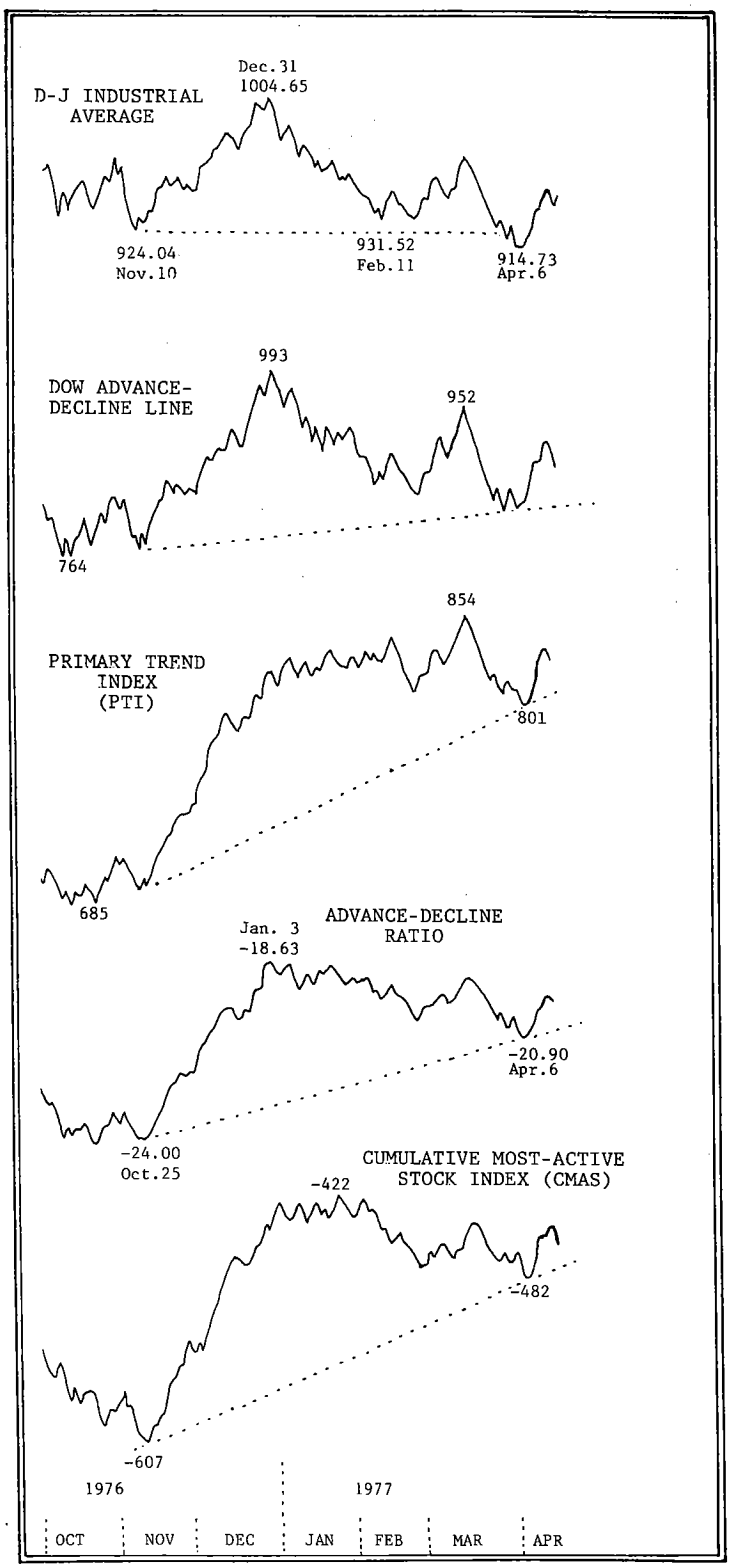
On April 6 the Industrials broke to a 14 month low, violating both its 924.04 low of last November and its 931.52 low of February 11. The Transports at the April 6 low put on a magnificent performance. Not only did they hold a whopping 9.3% above their late-1976 low but they even held above their preceding February 25 low of 221.81. In the face of this kind of multiple non-confirmation, the market reversed itself and exploded upward. On April 14 volume swelled to over 30 million shares (during the rally), highest volume for 1977.

As noted in the last Letter, the Utility Average was also playing its part in refusing to confirm on the downside. This money-



sensitive Average hit a low of 104.97 on February 25. Since then the Utilities have been climbing, and last week the Utility Average closed within a few points of its bull market high of 111.87 (a high recorded on January 25). Since the Utilities have often led the entire market both on the upside and the downside, the performance of this bellwether Average since February 25 must be taken as constructive if not outright bullish.

On April 14 the Transportation Average surged above its March peak, and this again puts pressure on Industrials to confirm. A confirmation would entail an Industrial rally above its March 16 peak (see page 1 chart) of **968.00**. The 968.00 level not only represents the March peak but it also represents the current level of the 200-day moving average of the Dow. Thus, a good deal of resistance may be expected on the upside from here, but any bettering of the 965-970 area on the part of Industrials would be highly bullish, I repeat–highly bullish.



The primary trend remains bullish, and the market has held together well during its consolidation-decline of the past nine months. In due time the bull will rule completely. But the bull doesn't charge on your command or mine. He moves when he's ready. Our job is to wait and to let the bullish forces accumulate.

STOUT BREADTH: I think this is a good time to study this daily chart of the Dow and four of the breadth indices that I follow. It's a rather dramatic picture and one that I take as broadly bullish. At the top of the chart we see what the public sees, the widely followed D-J Industrial Average breaking (during April) below the February 11 low of 931.52 and even below its November low of 924.04.

The next line traces my simple advance-decline index of the 30 Dow Industrials stocks. Here we see that although Dow prices broke, *Dow breadth held*. The inference is clear–a **limited** number of Dow stocks were responsible for the January to April slide. On a daily cumulative differential basis, the Dow A-D held.

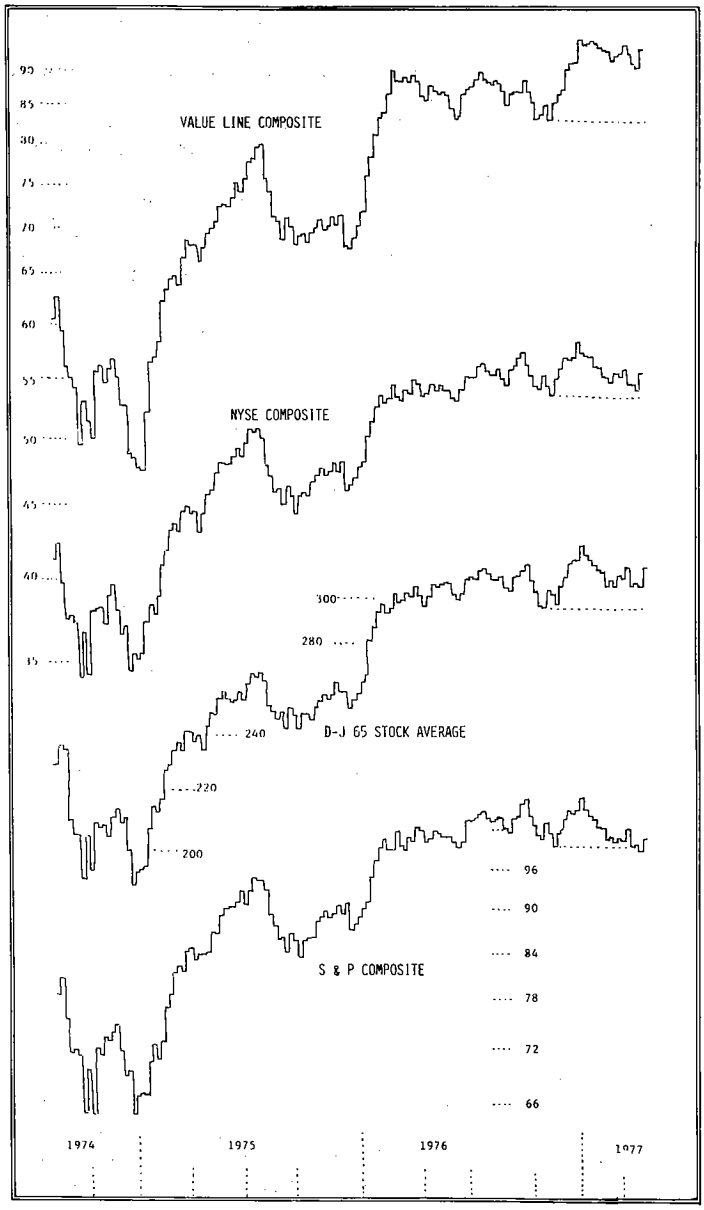
My *Primary Trend Index* of eight critical indices and averages didn't even begin to confirm the April break in the Dow. At its April 6 low of 801, the PTI was 116 points above its October low. This shows that there is a retained accumulation of strength in the PTI.

The Advance-Decline Ratio measures the rising or falling tendencies of *all* the stocks on the NYSE and it acts much like an unweighted average. What interests me is that the A-D is currently less than 2 points from its January 3 bull market peak, this after three months of downside action. That's an impressive performance.

The cumulative differential of the daily most-active stocks (CMAS) is still in a steep uptrend, with the decline from its January high having been mild. Surprisingly, CMAS is probably the strongest of all the breadth indices and (on any broad market strength) would probably be the first to push to a new bull market high.

In all, these four indices are, I feel, telling a constructive and hopeful story. Actually, the damage to these breadth indices could have been horrendous during a three-month market decline, one which took the Dow down almost 10%. But the damage has been minimal. That action should be enough to make any bear ponder his position.

MORE NON-CONFIRMATIONS: Last year I wrote a few pieces in which I stated that important market movements are invariably confirmed by the major Composite stock averages. In other words, the major Composites always "agree" with each other when a major move (either up or down) is in progress. Four of the Composite averages which I follow are pictured on the page 3 chart. All are drawn to ratio scale, so that they can be properly compared as to relative action (on ratio charts, all movements are shown in *percentage* of advance or decline). This chart is kept up on a weekly basis, with the Friday closes being shown.



On the 1977 decline the *NYSE Composite* of 1532 Big Board stocks got within a point of its November low of 52.90, but it has now rallied strongly to the upside. The *D-J 65 Stock Average* (made up of the D-J 30 Industrials, the D-J 20 Transports and the D-J 15 Utilities) got down to within 7 points of its October low of 295.85 during April, but this Average too has rallied strongly.

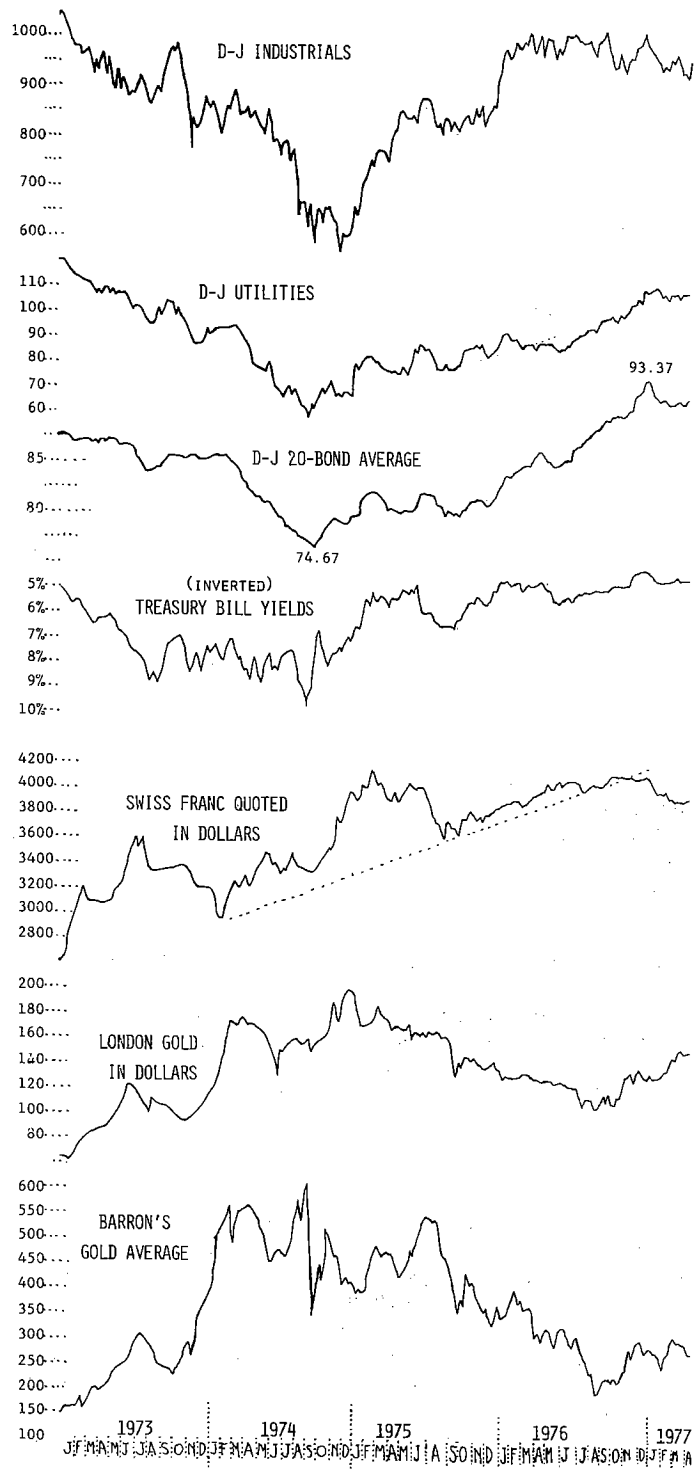
At the top of the chart we see the only unweighted Composite of the series, the *Value Line Average* of over 1600 NYSE, AMEX and O-T-C stocks. The Value Line is probably most indicative of the "average stock," and it is interesting to note that this Composite didn't get near its late-1976 lows during the recent sell-off. The Value Line Composite is currently within easy striking distance of a new bull market high.

At the bottom of the chart we have the only Composite to break its late-1976 low; and this is the *S&P 500*. But the action of one Composite does not make a trend, and non-confirmations on the part of the other three Composites is, I think, an impressive technical statement regarding the strength of this market.

A STORY IN INVESTMENT TRENDS: This is a chart that I often like to review. It tells a rather fascinating story of seven investment vehicles, including stocks, gold, and money. I like to view these items *in terms of dollars*, and in this case dollar investments at the 1974 bear market lows.

The final (1973-74) crash phase of the 1966-74 bear market is pictured on this chart. The end of the great slide occurred during the last quarter of 1974. What has happened since then is both interesting and informative, and I'll start with the Dow itself.

From its 577.60 low of December 3, 1974, the *Dow Industrial Average* advanced until it was about 65% above the '74 low. Obviously, a dollar invested in the Dow during December, 1974 has therefore proved to be an excellent investment (as is usually



the case during the beginning stage of a primary bull market). But from early 1976 to the present, "a dollar's worth of Dow" has proved singularly uninteresting. Dow movement has been sideways to down.

As of this writing, the *D-J Utility Average* has tacked on about 85% from its 1974 low of 57.93. That's a whopping gain, but even now the Utilities show little indication of wanting to correct in any important way.

The *D-J Bond Average* is now about 17 points above its 1974 low of 74.67, and at its current level the Bond Average shows a gain (from the '74 low) of about 23%. That's a tremendous rise for a bond market, particularly when you realize that the rise does not include the fat yields (above 10%) which could have been locked in at the bottom.

Veteran readers may remember my studies showing that a rising trend in *both Utilities and Bonds* provides a very constructive background for common stocks. I have drawn trendlines connecting important lows in both the Utility and Bond Averages and the clear inference is that both of these money-oriented Averages are strongly bullish. They have been bullish ever since the '74 lows.

The chart of *Treasury bill yields* (yields inverted) is remarkable because it shows a very stable pattern of T-bill yields ever since late-1975. Despite never-ending warnings about "coming sky-rocketing interest rates" and a "repeat of the 1974 credit crunch," the actual fact is that the T-bill yields have been holding in the 4.6% yield area all year. The consensus regarding interest rates could not have been more wrong.

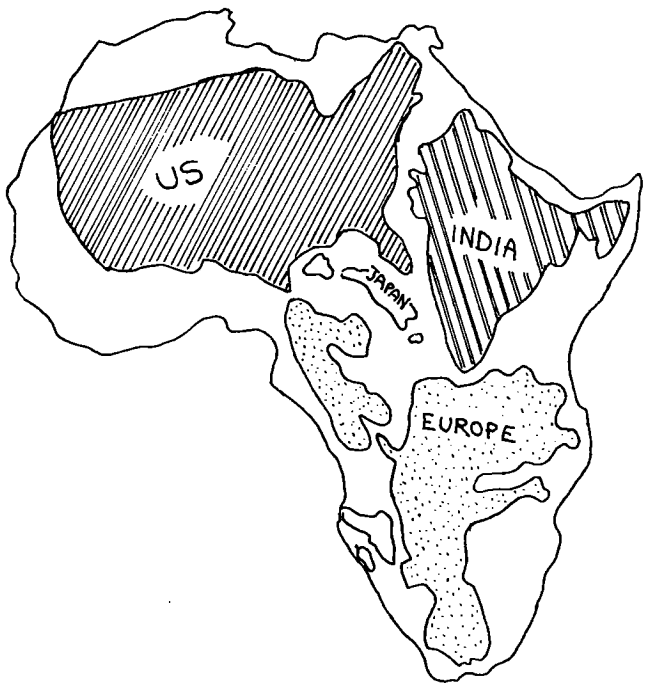
Next we come to the mighty *Swiss franc*, the currency bastion of the hard-money crowd. But what we see here is a bit puzzling. If you had bought Swiss francs for dollars in December, 1974 (the peak came in early 1975), you would now be losing money! Not only that, but over the past few months the Swiss franc has been sliding, having cracked its long rising trendline in November, 1976. I have been advocating getting out of Swiss francs for many months. I am still of the opinion that the franc is a sale.

Finally we come to *gold*, the "money of last resort." A dollar investment in gold in December, 1974 would now show you a loss of about 20% plus say an 8% annual loss in interest. But the trend of gold bullion as seen on the chart is now bullish so that it is possible that the loss could be recouped in a matter of time. Nevertheless, the hard fact is that gold has not been a profitable holding against dollars–unless you bought it after August, 1976.

Much the same may be said of the gold shares. The difference, however, is that the shares do provide dividends and the shares also have proved much more volatile. Because we are in a primary bull market in stocks, I have hesitated to recommend more than a 5% to 10% holding in gold and that in gold coins. I continue to be dubious about the gold shares with the exception of Homestake, which has now moved to the area where I feel it is fully priced.

I continue, by the way, to take the most serious view of the *African situation*. Our UN representative, Andrew Young, evidently does not feel the same way. He stated last week that the "Cubans are perhaps the most disciplined force in the Angolan situation." Young shows no apparent concern over the Soviet-Cuban invasion of Zaire, and it is clear at this point that no major Western power is going to interfere in that ominous situation. President Carter, obviously irritated, said this of the African mess (he said it last week in front of a *Time* reporter, *"We're just sitting around; I've told Cy* (Cyrus Vance) *that before."*

In my opinion, the Zaire invasion is just an early "feeler." If successful there, the Communists will turn to bigger things. I think it's clear that Russia's policy in the Mid-East has failed utterly. Russia is giving up on the Mid-East and is now turning her attention to Africa as the next step in the Russian policy of ultimate world domination. I drew this chart some months ago in an attempt to show how huge the continent of Africa is. Note that all of Europe, India, Japan and the US can be neatly fitted inside the African outline. Africa offers a lot more than space, it offers great wealth in the form of untold treasures in natural resources. If there is world trouble brewing and about to boil, this is where it lies–in Africa. Which may be why gold has been rising in price. Remember, Russia and S. Africa control a very high percentage of the world's gold output. Should Russia dominate S. Africa, or should a gold deal be made between them, the price of gold could be put substantially higher.



TIMING: It has long been my observation that during a primary *bull* market, things have a "way" of working out happily. That could mean that the whole African problem will simmer, but somehow not come to a boil until the next bear market begins. Which, I believe, gives us a few years grace (perhaps as much as five years). And that's all I have to say about gold and Africa in this report.

THE PICTURE: My friend, Al Kingon, Editor-in-Chief of *Financial World* magazine doesn't play around in his latest (April 1) editorial. He uses the rather hair-raising title, "The World is Broke." Mr.Kingon then lists a few of the more serious international problems, problems such as OPEC's draining of world monetary reserves, the shaky loans to the so called Less-Developed-Countries, and the onus of what seems to be perpetual inflation. Al's fears and thoughts are not confined to the offices of Financial World. Almost every day I receive letters from subscribers who note that the U S and world debt is climbing skyward like a Fourth of July rocket. In short, the mounting problems of uncollectible accounts and debt have been (and are) frightening thinking men from one end of the country to the other.

My answer is this, *"I know the U S and the world is technnically 'broke.' I've known it for years, and so has every one of my readers. It's not even a debatable question any longer. The real*

question, of course, the one that really occupies my time is 'When is the bankruptcy, and what may happen before the ultimate bankruptcy?'"

I guess it all goes back to the question John Magee used to ask from his office up in Springfield, Massachusetts. John is one of the pioneers of technical analysis, and he co-authored the classic, *"Technical Analysis of Stock Trends."* John used to have a sign hanging on his office wall, a sign which stated, **"Don't tell me what to buy, tell me when to buy it!"**.

In writing these reports, I have to deal with three basic, fundamental questions: (1) Is the primary trend now bullish or bearish? (2) Given either one, how is the situation likely to unfold and what do we do about it? (3) Where is the ultimate top (or bottom) of the move, and how drastic (in duration and extent) is the ultimate reversal apt to be?

Today it seems to me that we are hearing almost a consensus to the effect that we are heading into major trouble during late-1977 and 1978. At some point in the next year or so, we are told the great debt mountain that has been building since 1932 is finally going to catch up with us, and that is going to finish the whole ball game, it's going to mean "Kaput" for the Western world.

My thinking is that there is much **too much agreement** on the timing of this scenerio. My thinking is that the debt is indeed building, that the nation is indeed heading towards long-term trouble of disastrous proportions, but that current "predictions" are going to prove very wide of the mark.

I believe that October-December, 1974, represented a bottom of absolutely **major importance**, comparable to 1932 or 1942. From that 1974 bottom, I expect an Elliott-type three-wave (or three bull market) rise to a final high that could come in the early 1980's. Thus, today's world may well be "broke," but I do not expect the actual bankruptcy proceedings to begin until the early-1980's, probably at a Dow price far above anything which even the optimists are now envisioning.

LATE NOTES — ANOTHER MAJOR UPSIDE NON-CONFIRMATION – SOMETHING IS WRONG:

I usually put these reports together in final form during the course of two working days (on the second day the Letter goes to the printer). On occasion some important, even crucial, evidence appears just before the Letter is wrapped up. I think we're seeing such an instance now. I've said this before, and I want to say it again. What I write on the last page of these Letters under "Late Notes" represents the last thing I write before this Letter is rushed to the printer. Therefore the "Late Notes" section contains my final thoughts and my most up-to-date opinions. As such, Late Notes takes precedence over every other thing in the Letter.

On the market closing of April 19 I was tempted to scrap the whole report and start over. But I don't want to do that, because I want my readers to be able to follow my thought processes, I want them to see how I reason, and where my thinking **changes**, And right now I'm changing my thinking.

This is why I'm changing. On Tuesday, April 19, during an amazing,selective rally, the D-J Transportation Average spiked up to close at a new bull market high (see page 1 chart). Unfortunately, neither the Industrials nor anything else confirmed on the upside. Just as almost none of my market Averages and Indicators confirmed on the downside when Industrials broke to a 14 month low of 914.73 on April 6, none of my indicators confirmed on the upside with the extraordinary new Transport high of 237.63 of April 19.

Frankly, I did not like the solo Transportation high at all. If you study the page 1 chart, you will note that this same kind of Transport action occurred on January 3. On January 3 the Transports rallied to a new bull market high of 237.52 but at that time the Industrials at least had the strength to push above the 1000 level. This time Industrials literally "dropped dead" on the rally. They haven't even been able to approach their March high of 968.00.

Furthermore, in the face of the new Transport high, the Utility Average is now stalling and the A-D Ratio has turned sluggish. The whole "technical package" is beginning to bother me, and the more so as the week goes on.

Let's take the overall view. The big plus all along has been that the primary trend of the market remains bullish. It would require a total smash on the part of the Transports to confirm the Industrial weakness. Nevertheless, I am bothered, and I don't want any of my subscribers to get caught in what could be a vicious resumption of the **secondary** decline.

There are really two major considerations in dealing with the market at this time. (1) We are dealing with the nation itself, the future of the free markets, the structure of the entire system. Obviously, from that standpoint we all fervently hope that the primary trend of the market will remain bullish (and I think it will). The last thing this country needs at this time is a new primary bear market. Therefore, as long as the Transports continue to hold above 203.85 we can "take our hats off to them" and say that the primary trend remains bullish.

(2) But the second consideration is of immediate concern, and it is that you can lose your shirt during a vicious and extended correction within a continuing bull market. It makes little difference to the man who is wiped out that the primary trend is still bullish but that "unfortunately, he got caught in a secondary smash." Ask the man who rode them down during the corrections of 1957 or 1962.

Conclusion: **I don't like the latest solo new high in the Transports. The carrier high comes in the face of a series of *four declining peaks* in Industrials, the 1014.79 peak of Sept.21, the 1004.65 high of Dec. 31, the 968.00 high of March 16 and the very recent April 15 high of 947.76.**

This is the time for the market to prove itself. As this is written, Wall Street is trying to mount a rally. The whole strength of the market since this rally began on April 6 has been in the Transports. That Average is now up for its *ninth successive day*. Yet Industrials have not even been able to better their April 15 high of 947.76, the nearest of the four declining tops. If Transports "run out of steam" and turn down with Industrials failing even to better 947.76, we could well be moving into the trouble zone.

I want my subscribers to avoid riding through a potential market slide of perhaps drastic proportions. Yet, if Industrials continue this weak in the face of an extended Transport advance (extended on the upside), what might happen when Transports turn down? It's developing into a very "iffy" situation, and I most certainly

don't want my subscribers to buy stock here. Furthermore, if Industrials cannot even get above 947.76 (and preferably 968.00) on this rally, I would like subscribers to sell to the "comfort point."

What is the comfort point? The comfort point is the point where you would feel very, very comfortable if this market turned down and started sliding into a heavily over-sold position, a position which could easily take the Dow below 900.

Most of the various "non-Dow" stocks which I have recommended have held up extremely well during this difficult market, so far. As of this writing the A-D Ratio is still within 2 points of its bull market high. So far, so good, but I want to be very careful now. If in doubt, scale back, if you see the Industrial Average stalling here, scale back, take out insurance. The Industrials have been *much weaker* on this rally than I thought they would be, and this fantastic six-months divergence (which began in September) cannot last forever. If Industrials don't get in gear with Transports on the upside, then the Transports and the rest of the market are going to get in gear with Industrials–on the downside!

Put any cash from sales of common stocks into bonds, closed-end bond funds, no-load Municipal bond funds or even liquid-assets funds. There's nothing wrong with collecting fat interest checks while you're waiting for clarification from the stock market. And clarification sure isn't here yet–not by a long shot. Don't worry about the time to buy them back–I'll let you know when I think the next outstanding "buy spot" has arrived.

Question: Russell, I am confused. In the first part of the Letter, and in recent Letters, you have taken a constructive view of this market. Then towards the end of this Letter you turn negative and tell us to hold very little in the way of common stocks. As far as I can see, your advice is like "blowin' in the wind." I want steady, solid advice. Why can't you take a position and stick with it!

Answer: This is the toughest business I know of. There are 26 million stockholders in the nation and a handful of us (with any appreciable number of subscribers) in the business. Why so **few** successful advisors in a business with such a fabulous potential? The answer is self-evident. It's a tough business, and very few survive it.

There are no geniuses in this business, and the best of us are only intelligent hard workers who try to read (to the best of their ability) what the market is saying. Humility in this business means the ability to change your position, to stand fast at times, to give in at other times. Stubborn or arrogant investment advisers just don't last long on Wall Street. The market "eats 'em alive."

My first consideration is always the **preservation** of subscribers' capital. These days your capital (after taxes) is very, very hard to accumulate. Without your capital, you're a swimmer in the investment game without arms or legs. My second consideration is **return** or what the market will give you for your capital. With still-plentiful bond yields of 8% and above, I continue to consider bonds the "bargain of the securities field." My third consideration is possible appreciation of capital. Right now, in this market, I feel that the odds for appreciation (in common stocks) is dimming over the near-term.

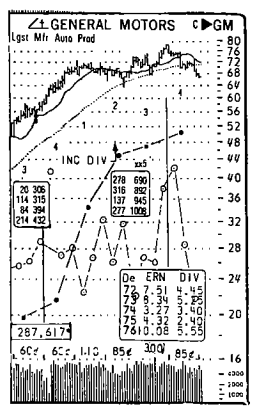
Right now I would rather my subscribers play the bond yield game than the stock appreciation game. I think that's where the better odds are. As far as "sticking to a fixed investment position," I'd love to do it, it would be a hell of a lot easier, but unfortunately, there are times when you can take a firm stand on the market, times when you have to change, and other times when you just don't know.

Veteran market practitioners tell me that 1976 and 1977 markets have been the "toughest they have dealt with in years." So be it. Our job is to make it through the tough markets and to make money in the easy markets. And that is exactly what I intend to do. If I am successful at it, I'll know that my subscribers' assets and my assets will be intact next year and the year after (and hopefully, larger as well).

GENERAL MOTORS: I'm not sold on the GM "buy" and "sell" signal rule. It's too easy, too automatic for me. But I do note that GM is now breaking down from a head-and-shoulders top pattern, and that's not good. It's not good because GM is so blasted big, it employs so many people, it is such a huge factor in the American economy.

I don't think the end of the automobile is in sight. I'm not even sure that President Carter's rather wishy-washy energy package is going to hit the auto industry that hard. But it is going to hit it, especially at the "big car" end, which is the highly profitable end. Furthermore, I can foresee the time when driving a big car is not only going to be unfashionable, it's going to be stupid. All this the stock of GM is discounting.

It's hard for the market to go against a "topping" GM. What affects GM affects thousands of suppliers and workers. So there you have it. I don't make the charts, the market does (and in this case *Quote Digest* drew this excellent little weekly chart. Their address is Box 212, Wichita, KA 67201).



INTERESTING NUMBERS: San Diego is now the 9th biggest city in the nation; it has expanded at a rate of 2% per year since 1961. Of the 25 biggest (in population) cities in the world, only two are in the US, New York and Chicago. Two-thirds of all Americans over 21 do not smoke. Roughly 45% of all the residential water used in drought-stricken So. California goes to watering lawns and shrubs. Government and its agencies employ 24% of all US workers. Colleges, churches, labor unions, etc. employ another 7.7%. Thus, about 32% of all US labor works at non-profit producing jobs. San Diego, I believe, has the distinction of being the worst place in the nation for marriages. The County is now recording 9 divorces for every 10 marriages.

NEXT MAILING: May 4th.

Correction: Letter 694 (mailed last week-April 13th) was erroneously dated April 6th.